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Uganda: Initial Assessment of Impact of the Coronavirus Pandemic on the Extractive Sector and Resource Governance

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Key messages

- Growing debt and significant delays in reaching "first oil" have left Uganda's economy more vulnerable to external shocks.
- Uganda's oil future is ever more uncertain as the global energy transition away from fossil fuels gains momentum; the country should manage its expectations and investment in the sector.
- Uganda could benefit from a future demand for strategic minerals, but without significant reform in the mining sector, the country risks missing out.

ABOUT THIS DOCUMENT

This is one of a series of country briefings produced by NRGI to summarize the evolving situation with respect to the pandemic and its economic impacts. The analysis it contains is subject to change with circumstances, and may be updated in due course.

SUMMARY OF ECONOMIC IMPACT OF THE CORONAVIRUS PANDEMIC

Uganda designed its new development strategy with a focus on agriculture, industrialization, tourism and oil production but now faces significant challenges because of the coronavirus pandemic. The government based its economic growth prospects on an overly optimistic assessment of the extractives sector as well as growth associated with investment in infrastructure, both of which are unlikely to materialize at the levels anticipated.

The International Monetary Fund (IMF) predicts that Uganda's economic growth will slow to 3.5 percent in 2020 from 4.9 percent in 2019. Uganda depends on imports of raw and intermediate goods and its economy relies significantly on the export of a range of key commodities. Consequently, the slowdown in the global economy, particularly in China, immediately impacted the country. According to PwC analysis, China's closure of manufacturing centers and ports led to a decrease in demand for Uganda's commodities, while closures of factories in China caused supply chain disruptions for manufacturers in Uganda.

In 2019, Uganda's public debt stood at 40 percent of its GDP and the IMF predicts that it will rise to 46.3 percent of GDP in 2020. Government debt consists mainly of non-concessional borrowing from China for infrastructure investment ahead of oil production. Coronavirus-related borrowing will likely take the public debt to over 50 percent of GDP in 2021. The IMF has classified Uganda as being at low risk of debt distress despite rising levels, but noted that the assessment made several assumptions, including that oil exports will begin again in 2023. That now appears unlikely.

Given growing concern about Chinese debt, Uganda is increasingly looking to traditional lenders. The Ugandan government plans to borrow about $500 million from the IMF for essential goods and public services. This implies that Uganda will have to abide by debt conditionalities including transparency around the use of the funds.

Uganda's growing budget deficit will likely constrain the government's ability to complete ongoing investment projects or meet debt obligations. Delays in commencing oil production will make it more challenging for the Ugandan government to pay off its debt. Continuing to borrow on the expectation of future large oil revenues increases Uganda's risk of experiencing the "presource curse."

IMPACT ON THE OIL AND GAS SECTOR

Uganda discovered oil reserves estimated at 1.7 billion barrels in 2006 but the country has experienced delays in moving from discovery to production. In 2019, negotiations for the final investment decision (FID) for the Lake Albert project broke down due to disagreements over tax issues related to the associated pipeline project, which further delayed the project. Total E&P's recent (April 2020) acquisition of Tullow Uganda's shares increased the prospects of the project going ahead but the situation remains uncertain as negotiations on the FID are likely to be affected by the global economic slowdown and low oil price. Furthermore, such acquisition of assets may not necessarily signal that projects are about to go ahead, which will most likely depend on the breakeven price for Uganda's oil project(s) relative to global crude oil prices.

Recent estimates put the breakeven point for the two projects that comprise the Lake Albert Development Project at $40 and $48 per barrel. (These estimates are based on a 10 percent discount rate, which may be low for the project type, meaning potentially higher break-even prices.) In any event, companies may have significantly less money to invest in new projects over the next few years. The viability of the project will be determined by investors' views of the global oil market over coming years since production is not expected to start until at least 2024. If the coronavirus pandemic and low crude oil prices further delay production, the delays in reaching "first oil" may be costly for Uganda, given that the country has borrowed heavily against the promise of future oil earnings. Already, interest seems to have started to wane in exploring other parts of Uganda for oil. Even before the coronavirus pandemic and the price crash the government had extended its latest licensing round "to allow more time for interested parties to prepare their applications."

Even if the Lake Albert project proceeds, government revenues are now likely to be lower than previously projected. In 2019, the government suggested it expected revenue to peak at around 4 percent of GDP with an oil price of $60 per barrel. This was already half that projected by the IMF in 2013, and even a long-term price of $60 could turn out to be optimistic.

Uganda has prioritized building economic links to the oil and gas sector. The government is committed to building an industrial park (including a refinery with a capacity of 30,000-60,000 barrels per day), an airport, and a petrochemical industry. Uganda's national oil company is expected to have a stake in this venture. These economic linkages may risk increasing dependence on, and investment in, extractives.

Despite the challenges, there is significant political pressure to finalize negotiations and move ahead with oil production. This comes from the president, who will likely focus on Uganda's oil future in the 2021 election campaign, as well as from politically connected private sector actors keen to finalize deals for oil-related supplies. (At the time of writing the 2021 elections were still planned although without a date. However, the president has made comments about postponement in light of the coronavirus pandemic.) The delay in FID negotiations has always been an attempt by the Uganda negotiation team to get a good deal for the country. The question is whether the negotiation team can or should now make the terms of investment more attractive to investors.

IMPACT ON THE MINING SECTOR

Uganda's mining sector currently generates only limited revenues due to limited large-scale activity and weaknesses in oversight of the sector. The lockdown is affecting operations at some mines and among artisanal miners. The slowdown may stymie government efforts to expand and formalize the sector, at least in the short term.

Uganda has deposits of minerals that are critical for energy transition technology. These include cobalt, tungsten, tantalite and copper. The government had instituted a ban on the export of tantalite, tungsten and tin before the coronavirus pandemic; it remains to be seen whether the government will lift the ban as part of concessions to the mining sector in light of the pandemic's economic impacts. The government has prioritized value addition – by which industry within Uganda refines and processes minerals before export, rather than exporting the raw commodity – and the establishment of a national mining company to increase the benefit for Uganda. The challenge will be to develop appropriate policy frameworks to guide value addition.

IMPACT ON EXTRACTIVE SECTOR REVENUES

The country has received meager revenues from extractives to date. Revenues so far from the oil and gas sector amounting to USD 690 million come mainly from signature bonuses, stamp duty and capital gains tax. Although mining operations have been in place for over 10 years, Uganda has failed to maximize revenues from mining. The auditor general's report for the financial year 2018/2019 revealed that the government collected only $3 million in royalties from mining. Overall, the pandemic's impact on revenues has been minimal because the revenues from extractives were not significant pre-pandemic. However, Uganda faces serious revenue management issues due to debt and the high likelihood of less foreign investment in oil and gas than predicted.

IMPACT ON NATURAL RESOURCE GOVERNANCE

In 2019, partly under pressure from donors, Uganda joined the Extractive Industries Transparency Initiative (EITI), a global good governance standard for oil, gas and minerals producers. There will be two countervailing pressures on transparency and participation in EITI. On the one hand, some government officials, especially in the Ministry of Energy and Mineral Development and the Petroleum Authority of Uganda, are skeptical about disclosure of data on the sector, which may undermine transparency efforts. On the other hand, Uganda's economic difficulties because of the coronavirus pandemic and low oil price are likely to mean

the country needs the support of international lenders and donors who will press for more transparency.

LOOKING AHEAD

Uganda is likely to face significant economic challenges as early optimistic predictions about the contribution of oil to the economy are unlikely to materialize. This may be exacerbated if Uganda's weak public institutions are not able to constrain corruption. The slowdown in the economy and the global move to reduce fossil fuels may reshape the narrative on the role of oil and gas in Uganda's economic future. Civil society organizations (CSOs) have a critical role to play in reshaping the narrative and promoting decisions that will benefit the people of Uganda. With significant political pressure to move ahead with the extraction of oil, it will also be important for CSOs to closely monitor any concessions that the Ugandan government may grant to investors in the wake of the oil price crash and coronavirus-related slowdown.

Moving forward, there is likely to be a stronger case for Uganda focusing on strategic minerals. However, without better management, Uganda may not realize the potential of its mining sector. The government will need to calibrate the country's approach to value addition well, to ensure that citizens benefit.

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